20 T.C. 610 (1953)

When a taxpayer omits more than 25% of gross income from a tax return, the statute of limitations for assessing additional deficiencies is extended to five years, and the Tax Court can consider increased deficiency claims made by the Commissioner even after the typical three-year statute has expired, provided the original deficiency notice was timely and a petition for redetermination was filed.

Summary

Deakman-Wells Co. filed income tax returns using the cash basis method, while maintaining books on an accrual basis. The Commissioner determined deficiencies and, in an amended answer, claimed an additional deficiency for 1947, more than five years after the return was filed. The Tax Court addressed whether the assessment of the increased deficiency was barred by the statute of limitations. The court held that because the taxpayer omitted more than 25% of its gross income, the five-year statute of limitations applied, and the Commissioner's claim was timely.

Facts

Deakman-Wells Co., a construction company, kept its books on an accrual basis but filed its federal income tax returns on a cash basis. For the tax year ending April 30, 1947, the company reported gross profit of $74,042.87 on its return, but its gross profit computed on the accrual basis would have been $146,737.74. The return was filed on July 15, 1947. The Commissioner sent a deficiency notice on June 27, 1951, and later claimed an increased deficiency in an amended answer.

Procedural History

The Commissioner determined deficiencies in income taxes for the years 1947-1950. The taxpayer petitioned the Tax Court for a redetermination of the deficiencies. The Commissioner then filed an amended answer claiming an increased deficiency for the year 1947. The Tax Court was asked to decide if the statute of limitations barred the assessment of the increased deficiency.

Issue(s)

Whether the assessment of the increased deficiency for the taxable year ended April 30, 1947, is barred by the statute of limitations.

Holding

No, because the taxpayer omitted more than 25% of its gross income, triggering the five-year statute of limitations, and the Commissioner's amended claim was permissible under Section 272(e) of the Internal Revenue Code after a timely original deficiency notice was sent and a petition for redetermination was filed.

Court's Reasoning

The court reasoned that the taxpayer's method of filing on a cash basis while keeping books on an accrual basis was not in accordance with Section 41 of the Internal Revenue Code, which requires computation of net income in accordance with the method of accounting regularly employed. Because the taxpayer omitted over 25% of its gross income, the five-year statute of limitations applied. The court noted that it is not sufficient that the figures appear somewhere in the return; they must be "included in and taken up as gross income." The original deficiency notice was timely under Section 276(d). Once the petition for redetermination was filed, the statute of limitations was suspended under Section 277, and Section 272(e) permits the Commissioner to claim an increase in deficiency at or before the hearing. The court distinguished cases cited by the petitioner involving claims for refunds, noting that the Commissioner is permitted to claim increased deficiencies in Tax Court proceedings.

Practical Implications

This case clarifies that for tax returns, the reporting of "gross income" on the return itself is what triggers the extended statute of limitations under Section 6501(e) of the Internal Revenue Code (which replaced the prior Section 275(c)). It reinforces that merely having information available within the return is insufficient if it's not reflected in the calculation of gross income. For tax practitioners, this underscores the importance of accurately determining and reporting gross income to avoid extended scrutiny. Furthermore, it demonstrates the Tax Court's broad authority to consider increased deficiency claims raised by the IRS even after the standard limitations period, as long as the initial deficiency notice was timely and the taxpayer petitioned the Tax Court.

